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**AMIR Program**  
**Access to Microfinance & Improved Implementation of Policy Reform**

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**Consultant Report to AMIR**

**Amendments to Customs Law #20 of 1998**

By  
Thomas E. Davis

**Submitted to:**  
United States Agency for International Development

**Submitted by:**  
Chemonics International Inc.

November 25, 1999

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## **Consultant Report to AMIR**

(Access to Micro Finance & Improved  
Implementation of Policy Reform)

By  
Thomas E. Davis<sup>1</sup>  
November 25, 1999

This report summarizes my activities while serving as an economic consultant to the Central Bank of Jordan (CBJ) during the period October 19 to November 25, 1999. The report is submitted to AMIR in accordance with an agreement to provide such a report at the conclusion of my visitation to the bank.

### **Tasks of Consultant**

The Scope of Work attachment to my consultant agreement stipulated my tasks, inter alia, as follows:

1. Provide consulting services to the CBJ with regard to monetary policy,
2. Deliver lectures to research department staff and other CBJ staff as needed on recent developments in monetary policy,
3. Assist the CBJ in an ongoing assessment of their policy formulation requirements,
4. Provide suggestions to help the CBJ staff stay current with monetary policy developments,
5. Assist in reviewing two separate SOWs for Macroeconomist/Econometrician and Human Resources Management of Auditing Department of the CBJ, and make any revisions deemed necessary and/or appropriate.

### **Tasks Performed by Consultant**

#### Task 1. Provide consulting services to the CBJ with regard to monetary policy.

On October 21, 1999, I was escorted to the CBJ by Mr. Jamal Al-Jabiri of USAID. At the bank, I met initially with Dr. Ghassan Ifram, Head of the Research Department and then privately with Governor Ziad Fariz. At these meetings, I stated my willingness to assist the CBJ with respect to its monetary policy responsibilities as set forth above.

In the following weeks of my visitation, I met frequently with Dr. Ifram about monetary policy matters. I also met frequently with Governor Fariz and Deputy Governor Mustafa. During these meetings, we discussed a wide range of topics pertaining to the economic and monetary policy situation generally and to the current and prospective situation in Jordan

In performance of Task 1, I offered my views on policy matters during these meetings with

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<sup>1</sup> Mr. Davis is a former Senior Vice President and Director of Research at the Federal Reserve Bank of Kansas City.

Governor Fariz, Deputy Governor Mustafa, and Dr. Ifram.. Included among the views I offered was the desirability of developing the depth and breadth of financial markets in Jordan, including the market for Treasury bills, the interbank market for reserves, and the foreign exchange market. The topics and substance of discussions pertaining specifically to monetary policy matters must understandably remain confidential by prior and mutual agreement.

Task 2. Deliver lectures to department staff and other CBJ staff as needed on recent developments in monetary policy.

Early in my visitation, I discussed with Dr. Ifram his desired approach to my lectures on recent developments in monetary policy. It was agreed that he would select the individuals to attend the lectures from the research department and the bank. He preferred the number of attendees be limited to those who had the required background and experience to benefit from the material. He also preferred the lectures be held towards the end of my visitation to allow time for me to complete my other tasks. We further agreed the lectures should be similar to the interactive seminar approach I used in the lectures I presented earlier this year.

In performance of Task 2, I presented a series of five lectures to selected staff members of the CBJ during the week of November 14, 1999, Per agreement with Dr. Ifram, the lecture material was adjusted to fit the interests and abilities of the attendees. While not all topics in the attached outline were discussed, effort was made to keep the lectures focused on recent developments in monetary policy to provide attendees an understanding of the foundations and principles of central bank monetary policy.

Also in performance of Task 2 and my consultant agreement, attached is a Summary of my lecture material prepared as a detailed topical outline entitled "Monetary Policy Issues and Developments." Information on bank members attending the lectures is included.

Task 3. Assist the CBJ in an ongoing assessment of their policy formulation requirements.

As background, this author prepared a report earlier this year entitled "An Assessment of the Monetary Policy Needs of the Central Bank of Jordan." That report was summarized in my consultant report to AMIR on April 4, 1999. The report contained three broad observations. It was found the bank needed to further develop its tools for conducting open market operations, improve its ability to access and analyze economic information, and improve its staff understanding of monetary policy issues. The report contained recommendations to address these needs.

The assignment in Task 3 is essentially an extension of the work begun earlier this year. In assessing monetary policy formulation requirements, the focus of the current assignment is by definition not on how policy is implemented or on the tools of monetary policy but on how policy is formulated. Since economic information and research is critical to the formulation of central bank monetary policy, the focus of Task 3 is necessarily on the research activities of the bank and identifying the needs of the Research Department with regard to monetary policy formulation.

In performance of Task 3, I assisted in an ongoing assessment of the policy formulation requirements of the bank by making an assessment of the needs of the Research Department to contribute to bank monetary policy formulation. Observations were made on the Research

Department's current organization, procedures, personnel, and access to economic information. The observations are summarized in the attached report entitled "Report to AMIR on Research Department Needs at the CBJ." The report also contains recommendations for meeting such needs.

Task 4. Provide Suggestions to help CBJ staff stay current with monetary policy developments.

In this consultant's report to AMIR in April of this year, as mentioned above, there is a recognized need to improve staff understanding of monetary policy issues and developments. This need is pointed out again in the attached "Report to AMIR on Research Department Needs at the CBJ."

In performance of Task 4, I provided suggestions to help CBJ staff stay current with monetary policy developments. These suggestions are listed in support of recommendations number 2, 3, and 4 in the attached "Report to AMIR on Research Department Needs at the CBJ."

Task 5. Assist in reviewing two separate SOWs for Macroeconomist/Econometrician and Human Resources Management of Auditing Department of the CBJ, and make any revisions deemed necessary and/or appropriate.

Early in my visitation, I reviewed the two SOWs mentioned above for the purpose of clarifying some points of confusion in the SOWs.

In performance of Task 5, I e-mailed my comments and suggested revisions to Chemonics in Washington DC on Oct. 23, and they copied them to AMIR. On Nov.2, I met with Andy Griminger of AMIR about the SOWs, and during that visit relayed Dr.Ifram's views about the SOWs. Dr. Ifram said he could not comment on the request by the Human Resources Department for a consultant. He further indicated he preferred to have two separate consultants, a Macroeconomist and an Econometrician, rather than one consultant who combines those two specialties. I drafted a list of possible Tasks for each of these two consultants, as requested by Andy Griminger, and sent the draft to Dr. Ifram for his review and a copy to Andy Griminger for his information. On Nov. 16, Dr. Ifram indicated the tasks were acceptable to him, and I relayed that information to Andy Griminger.

**Conclusion**

As set forth in this report, and as supported by the attached information, I believe the five consultant tasks listed above have been completed as requested. Additional copies of this report, as requested in the consultant agreement, will be forwarded to the appropriate persons at Chemonics and AMIR as soon as possible.

# Monetary Policy Issues and Developments

A Summary of Lecture Material for Presentation  
At the Central Bank of Jordan

By  
Thomas E. Davis<sup>2</sup>  
November 1999

## I. Evolution of Central Banks: Basic Issues and Concepts

1. Why Study Money?
2. What is Money?
  - Origins
  - Functions
  - Types
3. Evolution of the Payments System
  - Development of Banks and the Banking System
  - Principles of Bank Management
4. Development of Government Banks to Support Currency
5. Development of Government Banks to Support Banks
  - Banking Panics
  - Establishment of Early Central Banks
6. Development of the Tools of Monetary Policy: The Federal Reserve
  - Reserve Requirements
  - Lending at the Discount Window
  - Open Market Operations
7. Establishment of Other Central Banks
8. The Money Supply Process
  - Assets and Liabilities of a Central Bank
  - Multiple Deposit Creation
  - Control of the Monetary Base
    - Central Bank Lending
    - Central Bank Open Market Operations
    - Foreign Exchange Market Intervention: Sterilized and Nonsterilized
    - Other Factors
1. Measuring Money
  - Definitions of Money: Theoretical and Empirical
  - Reliability of Money Data
2. Other Functions of Central Banks

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<sup>2</sup> Mr. Davis is a former Senior Vice President and Director of Research at the Federal Reserve Bank of Kansas City.

- Payment System Support
- Banking Regulation and Supervision
- Government's Bank

## **II. Conduct of Monetary Policy and the Federal Reserve System**

1. Structure of the Federal Reserve System
2. Role of Financial Institutions and Financial Markets
  - Bank and Nonbank Institutions
  - Money, Bond, and Equity Markets
3. Goals of Monetary Policy
  - Economic Growth
  - Price Stability
4. Federal Reserve Policy Procedures
  - Early Years Reliance on the Discount Window
  - War Finance and Pegging of Interest Rates
  - Targeting Money Market Conditions
  - Targeting Monetary Aggregates
  - Current Procedures
5. The FOMC Meeting: Developing a Directive
  - Preparation by Research Staff
  - Beige Book, Green Book, Blue Book
  - The Meeting
  - Reports by Research Staff
  - Choosing a Policy
  - The Directive
6. Implementing the Directive
  - Reserve Estimates
  - Developing a Nonborrowed Reserve Path
  - The Federal Funds Target
7. Conducting Open Market Operations
  - Outright Purchases and Sales of Securities
  - Temporary Purchases and Sales: RPs and Reverse Rps.
  - Foreign Central Bank Transactions

## **III. Conduct of Monetary Policy and the Central Bank of Jordan**

1. Goals of Monetary Policy
2. Tools of Monetary Policy
3. Current Issues

## **IV. The Monetary Policy Transmission Process**

1. Evolving Views of the Policy Transmission Process

Report

- Keynesian
  - Monetarist
  - Rational Expectations
  - Yield Curve
2. Sectoral Effects of Monetary Policy
  3. Long Run and Short Run Effects on Output and Inflation: Are There Trade Offs?

**V. Econometric Models**

1. The FRB/US Model of the US Economy: An Example
2. Properties of the Model
  - Effect of Policy on Financial Markets
  - Effect of Financial Market Conditions on Spending
  - Effect of Aggregate Income Changes on Spending
  - Effect of Output Changes on Inflation
3. Shocks to the Model
  - Demand Shock: A Shift in Equity Premiums
  - Price Shock: An Acceleration in Wage Compensation
  - Supply Shock: A Shift in the Level of Productivity
4. Monetary Policy and Macroeconomic Performance
  - Trade Offs Again
  - Variability of Output and Inflation: The New Trade Off
  - Discretion Versus Rules
  - Central Bank Reaction Functions: The Taylor Rule for Stabilization of Output and Inflation

**VI. International Issues in Monetary Policy**

1. The Special Role of the Dollar in International Financial Markets
2. Exchange Rate Regimes
  - Fixed
  - Floating
  - Variations
3. The Bretton Woods System and its Aftermath
4. Recent Shift to Floating Rates
5. Recent Increase in International Mobility
6. International Transmission Channels of Monetary Policy
7. Currency Boards : What Are They?
  - Pro's and Con's
8. Dollarization: What is it?
  - Pro's and Con's
9. Getting the Exchange Rate Right in the 1990's: Fixed or Flexible?
  - Macroeconomic Performance Under Different Regimes
  - Choosing a Regime
  - Challenges of Fast Growth and Capital Mobility
  - The Impossibility Theorem
  - Implications for the CBJ

## **VII. Current Issues for Monetary Policy Makers**

1. The New European Central Bank
  - Organization and Tasks
  - Monetary Policy Tools
  - Recent Policy Actions
  - Challenges
2. The Asian Financial Crisis: Causes, Cures, and Systemic Implications
  - Origins of the Crisis
  - Financial Sector Weakness
  - External Sector Weakness
  - Contagion Effect
  - Moral Hazard Effects
  - Prudential and Supervisory Standards
  - Lessons to be Learned From the Crisis?
3. Capital Account Liberalization
  - Costs and Benefits
  - Risk Management and Prudential Regulation
  - Implications for Sequencing of Liberalization Measures
  - Implications for the IMF
  - A New International Financial Architecture?
4. How Should Monetary Policy be Conducted in the Presence of Asset Bubbles and Financial Crises?
  - Efficient Markets, Fundamental and Nonfundamental Disturbances
  - Macroeconomic Implications
  - A Strategy of Flexible Inflation Targeting and Financial Stability
  - Recent Central Bank Experience: Brazil, Czech Republic, Japan
5. How Should Monetary Policy be Conducted in an Era of Price Stability?
  - Defining Price Stability
  - Maintaining Price Stability
  - Credibility
  - Deflation and Implications
  - A Liquidity Trap and the Case of Japan
  - Inflation Targeting and Price level Targeting
  - Macroeconomic Performance Under Inflation Targeting
  - Applicability to Developing Countries
6. Exchange Rates, Financial Fragility, and Monetary Policy
  - Some Theoretical Issues
  - Is it Now Flexible Rates Versus Dollarization?

## **VII. Millenium Challenges for Monetary Policy**

1. Policy Objectives in a Low Inflation World
2. The Transmission Mechanism in a Low Inflation World
3. The Transmission Mechanism With Greater Globalization



Report

4. The Growth of Monetary Unions
5. Detecting Economic Paradigm Shifts in the New World Economy  
The Future of Central Banks

**Addendum: CBJ Attendees at Lectures**

Mr. Walid Zinati	Section Head	Monetary Affairs Division	Research Dept.
Mr. Mohammad Khreisat	Economist	Monetary Affairs Division	Research Dept.
Mr. Nedal Assam	Economist	Monetary Affairs Division	Research Dept.
Mr. Hassan Abu Rashed	Supervisor	External Economy Division	Research Dept.
Mr. Ammar Jarrar	Economist	External Economy Division	Research Dept.
Mr. Mohammad Al-Hazaymeh	Economist	National Economy Division	Research Dept.
Mr. Osama Sweidan	Economist	National Economy Division	Research Dept.
Mr. Rajih Khodor	Economist	National Economy Division	Research Dept.
Mr. Jamal Al-Asal	Supervision	Statistical Division	Research Dept.

## **Report to AMIR On Research Department Needs at the CBJ**

By  
Thomas E. Davis  
November 1999

This report provides an assessment of the needs of the Research Department at the Central Bank of Jordan (CBJ) to contribute to the monetary policy requirements of the bank. The Research Department is targeted because economic research is deemed critical to the process of formulating central bank monetary policy. Economic research provides the information and analytical foundations required by monetary policy makers. As a result, it is important that the contribution of economic research to monetary policy formulation be relevant, of high quality, and presented effectively to monetary policy makers at the bank.

At the outset, it should be stated that the conduct of monetary policy is now widely recognized and accepted to be a central bank's primary responsibility. Therefore, if high quality economic research is not part of the process of policy formulation at a central bank its ability to properly perform its primary responsibility of conducting monetary policy can be jeopardized over time.

### **Observations and Recommendations**

To assist the CBJ in an ongoing assessment of their monetary policy formulation requirements, observations were made on the Research Department's organization, procedures, personnel, and access to economic information. These observations on the needs of the department are summarized below along with associated recommendations.

Observation 1. The Research Department currently does not have a documented mission or goal to support monetary policy formulation.

- The department's implicit mission, which is typical of research departments at central banks in developing countries, is to gather and report on economic data. As a result, there are no administrative procedures in place intended to develop and direct economic research for purposes of monetary policy formulation.

Recommendation 1. The Research Department needs to develop a mission statement setting forth a goal to support bank monetary policy formulation.

- Administrative procedures to support the department's mission statement also should be developed, including a document setting forth the department's planned research activities and new initiatives for the upcoming year. The document should be submitted to senior management for review and acceptance; and at year end, additional documentation should be submitted showing to what extent the department achieved its planned objectives. Implementation of such procedures will help management direct and control research activities on policy related issues.
- To further assist management in directing research, the department should consider establishing a Research Planning Committee within the department. The purpose of the committee would be to plan and monitor research projects and activities in a manner

consistent with the department's mission and objectives.

Observation 2. The Research Department's new organizational arrangements are not yet effectively contributing to the preparation of economic research for monetary policy formulation.

- The Research Department was reorganized this summer to better focus its resources on relevant economic areas. The reorganization, which was recommended by this author earlier in the year, involved a consolidation of divisions within the department. As a result, there are now three economic divisions in the department: the monetary affairs division, the national economy division, and the external economy division. In addition, there are two support divisions: the statistics division and the library.
- The reorganization also established an Economic Policy Committee in the department, as was recommended. The purpose of this committee, which is to be attended by representatives from the three economic divisions, is to meet on a regularly scheduled basis to discuss monetary policy-related issues.
- These reorganization efforts were clearly appropriate. However, they have not yet had a noticeable effect on shifting the emphasis of the department from its traditional data reporting role to producing analytical research for monetary policy formulation.

Recommendation 2. The Research Department needs to implement the intended operation of the Economic Policy Committee.

- For each meeting of the Economic Policy Committee, material should be prepared and presentations made on the national economy, the external economy, and recent financial and monetary developments. Material prepared and discussed for these meetings could be used as a basis for the department's contribution to the formulation of bank monetary policy.
- If implemented along these lines, the Economic Policy Committee will help department staff stay current on monetary policy developments.

Observation 3. The Research Department is short of trained staff to conduct high-quality economic research for policy formulation.

- There are currently only two Ph.D. economists on the department staff, which is unusually low for a central bank. While a number of staff members are studying abroad to earn their Ph.D., which is a commendable practice given the need for economists, the result is that the department is unusually devoid of trained analysts to perform high-quality analysis of monetary policy issues.

Recommendation 3. The Research Department needs to improve the ability of its staff to conduct research related to monetary policy issues. Some recommended actions are listed below.

- Increase the number of Ph.D. economists on the staff while reducing the number of less qualified staff. Impose a temporary moratorium on the long-term departure of qualified staff to earn their Ph.D. degrees until an agreed upon minimum level is attained.
- Continue the development work begun on building an econometric model of the Jordanian economy because of its value as a training device for the staff and as a potentially useful forecasting tool for policy deliberations.
- Continue efforts to attract visiting lecturers to train existing staff on economic research and monetary policy issues.
- Implement the intended operation of the Economic Policy Committee, as described

above.

- Establish an Economic Seminar program as an in-house training mechanism. Seminar meetings could be held for staff members so they could discuss their research and the research of others. The department head could assign topics and papers for discussion to teach and quid department staff about policy issues.
- If implemented, these actions should help the staff stay current on recent monetary policy developments.

Observation 4. Access to timely and relevant economic information is a continuing and serious problem.

- Efforts are underway at the bank and the Department of Statistics (DOS ) to improve the quality and timeliness of GDP data. Efforts also are underway to develop an econometric model of the Jordanian economy using such data. However, progress has been slow in these areas and in developing computer systems to process data efficiently so they are readily available for analysis in the department. In addition, information on current financial market developments nationally and internationally is not readily available to department analysts.

Recommendation 4. The Research Department needs to improve its sources of economic information. Some recommended actions are listed below.

- Develop a “*Survey of National Economic Conditions*”. The purpose of the survey would be to obtain current up-to-date information on the economy in a qualitative not quantitative form. The survey would be a useful supplement to GDP data, which are not timely and have a long time lag. The survey could be conducted quickly and simply on a regular basis throughtout the year using the telephone to obtain comments from respondents representing key sectors of the Jordanian economy. The results of the survey should be summarized in written form and submitted to the Governor and Deputy Governors for use in monetary policy deliberations.
- Make access to an international financial news service readily available to department researchers. Information obtained should be accessible on selected PC’s in the department and the bank. Printed hard copies of daily financial developments could be distributed to other selected staff members in the department.
- Make access to the Internet more accessible to staff researchers. The Internet is now the principal way economic information is being transmitted around the world. E-mail between economists, financial news, economic data, and research results of academicians, central bankers, and international institutions are all being communicated via the Intenet. To facilitate ready access to the Internet, the office PC of economists in the department need to be increased, upgraded, and made Internet compatible.
- If implemented, these actions should help the staff stay current on recent monetary policy developments.

## **Conclusion**

These recommendations were submitted to Head of the Research Department for review and consideration.

